Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)))	CC Docket No. 96-98

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

**OPPOSITION OF KMC TELECOM, INC.
TO JOINT MOTION OF GTE CORPORATION AND THE
SOUTHERN NEW ENGLAND TELEPHONE COMPANY
FOR STAY PENDING JUDICIAL REVIEW**

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SUMMARY

Issuance of a stay would cause irreparable injury to companies seeking entry to the local exchange market, by delaying their entry or subjecting them to entry on terms incompatible with effective competition. This more than offsets the claimed injury to incumbent LECs if new competitors are allowed entry on terms later found to have been overly-generous. Moreover, the public interest in competitive local exchange rates, as well as the pro-competitive goals of the Act and the Congressional intent that these goals be achieved promptly, are more likely to be achieved by requiring interconnection to proceed according to the framework established by the Commission's regulations. The incumbent LECs can protect themselves by requiring reopener clauses to account for any changes in the regulations that may result from judicial review. There is no reason to believe that revision of agreements or arbitration awards to account for any such changes would be any more difficult than the revisions that would be necessary if operation of the regulations were suspended by a stay and the regulations were then upheld.

In addition, there has been no showing that the regulations are likely to be overturned on judicial review. Section 251(d)(1) of the Act gives the Commission broad authority, including authority to establish pricing principles and methodology as well as default proxies. In addition, the Commission has sufficient authority under section 4(i) of the Communications Act to support its actions.

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OPPOSITION OF KMC TELECOM, INC. TO JOINT MOTION OF GTE CORPORATION AND THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY FOR STAY PENDING JUDICIAL REVIEW

KMC Telecom, Inc. ("KMC") is a new provider of competitive access service throughout the nation. With the passage of the Telecommunications Act of 1996, KMC plans to provide local exchange service in competition with incumbent local exchange carriers, focusing its initial efforts on smaller markets outside of the 100 largest MSAs.

I. KMC WILL SUFFER IRREPARABLE INJURY IF A STAY IS GRANTED WHICH OUTWEIGHS THE INJURY CLAIMED IN THE MOTION.

KMC is presently engaged in negotiations with several incumbent local exchange carriers ("ILECs") seeking interconnection with and access to the local exchange network in several markets where significant local competition does not now exist. If a stay is granted, the ILECs would have every incentive not to agree to any arrangement that does not incorporate their counsels' most extreme interpretation of what terms the Act permit. Since agreements on these terms would cripple effective local competition, KMC would be faced with the choice of either consenting to the ILECs' terms or facing the further delays of State commission arbitration, followed by the inevitable appeals to the courts. While the Act imposes deadlines on State commission arbitration, it provides for appeal to a federal district court (appeals that are not subject to any statutory deadlines); and if no Commission rules are in place, the ILECs have every incentive in every case to litigate their version of what the Act requires. Given the often lengthy delays of district court litigation and appeals, and the likelihood of conflicting decisions between districts, it is reasonable to anticipate that the entire process would take years, during which KMC and other competitors will be denied access to the local exchange market.

Any significant delay in access to the local exchange market will cause KMC significant injury, as the ILECs continue to reap the benefits of their monopoly position and engage in special promotions designed to make it more difficult for competitors to attract customers when they finally gain access. Moreover, once the Commission's Rules are sustained, there would be no practicable way for KMC and other similarly-situated competitors to recover the business losses inflicted by a stay. The injury would be irreparable.

KMC's only alternative would be to agree to terms incorporating the ILECs' litigating position. However, it cannot be expected that such agreements would be compatible with effective local competition. For example, the ILECs seek interconnection rates embodying full recovery of embedded cost, according to allocation formulas designed to maximize the charge. At the same time, however, State commissions are increasingly allowing LECs the flexibility set retail prices at levels that do not reflect full embedded cost recovery, in areas where they are facing competition.[1] As the Department of Justice has pointed out, the result is a classic price

[1] E.g., New York Telephone Company - Track II, Case 92-C-0665 (N.Y.P.S.C. June 16, 1995) (granting New York Telephone "pricing flexibility for new competitive services for a period of five to seven years"); Chesapeake and Potomac Telephone Company of Maryland, Case No. 8150, Order No. 70167 (Md. P.S.C. October 28, 1992) (competitive pricing for Centrex services).

squeeze, in which the competitor must pay an access charge higher than the incumbent carrier's competing retail rate. If the issuance of a stay leads to that type of agreement, the advent of effective local competition will be further delayed, and KMC will also suffer significant and irretrievable loss of business.

The Motion argues that if the Rules are eventually sustained, it would require "little effort" to revise any non-compliant agreement negotiated during the period of a stay (Motion at 37-38); while if the Rules are overturned, it would be "impracticable, if not impossible," to revise agreements negotiated while the Rules were in effect. Motion at 29. The ILECs cannot have it both ways. There is no reason why the practical difficulties of amending an existing agreement would be more or less significant depending on whether the amendment is for the purpose of conforming a non-compliant agreement to the rules, or amending a compliant agreement to conform with whatever new standards might emerge following judicial review. There is no support for the Motion's argument that any adjustments to conform to the Rules would be relatively minor, while adjustments the other way would not. For example, if an agreement for interconnection at a rate reflecting full embedded cost recovery, negotiated during the period of a stay, were amended to reflect the pricing principles in the Rules after they are upheld on judicial review, there could be a dramatic effect on the interconnection rate. And where the rate is changed significantly, it would be difficult to insulate the other terms of the agreement from renegotiation, thus entailing the high transaction costs that the Motion asserts would occur only if a stay is <u>not</u> issued.

The Motion argues that high transaction costs would discourage the parties from negotiating particularized agreements if no stay is issued and the Rules are eventually invalidated. Motion at 37-38. But if that is true, then issuance of a stay would cause the parties to incur significant transaction costs in negotiating particularized agreements while the litigation is pending, that will prove to have been unnecessary if the Rules are upheld. The Motion does not explain why higher transaction costs to negotiate particularized agreements during the period of litigation are less significant than the transaction costs they posit in adjusting to the results of the litigation if the Rules are overturned. Moreover, the ILECs can protect themselves by insisting on reopener clauses in any agreements negotiated or arbitrated during the period of litigation, thus requiring parties to renegotiate if the Rules are overturned on appeal. If, as the Motion asserts, compliant agreements negotiated during the period of litigation put them at a significant disadvantage, it is not credible to assert that transaction costs would discourage them from insisting on renegotiation; and reopener clauses would give them the right to insist on renegotiation in the event the Rules are overturned.

In short, the possible difficulty of undoing existing arrangements is simply an inevitable result of the uncertainties of litigation, and is a problem regardless of whether a stay is issued. It in no way supports the issuance of a stay.

Moreover, the Motion's concept that the Commission's regulations will impose a "uniform mold" on what would otherwise be "free negotiations," Motion at 38, reflects at best a severe distortion of the statutory process. Even absent the Commission's regulations, Section 252(e)(2)(A) of the Act precludes approval of any negotiated agreement that discriminates against a carrier not party to the agreement; Sections 251(b) and (c) require that any agreement adopted through arbitration be nondiscriminatory in numerous respects; and Section 252(i) requires that an incumbent LEC "shall make available any interconnection, service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement." These provisions will inevitably lead to uniformity among agreements, at least in rates and other material terms and conditions, regardless of any requirements imposed by this Commission. The spectre of high transaction costs to negotiate a large number of non-uniform agreements is therefore extremely unrealistic.

Aside from its specious argument concerning possible difficulties of undoing existing interconnection arrangements negotiated during the period of litigation, the Motion argues that the ILECs will be damaged if no stay is issued, because they will lose business if competitors gain access on terms later held to have been overly-generous. But if a stay is issued and as a result KMC (and similarly-situated firms) are denied access on terms allowing effective competition, these prospective local exchange competitors will lose the business they otherwise would have obtained, with no feasible way of recovering the loss. There is no basis for the ILECs to assert that somehow their potential loss of business is more deserving of the Commission's solicitude than that of KMC and other like companies.

The argument of irreparable injury made by the Motion is especially weak with reference to default proxy pricing. The Commission has made it plain that default proxies are to be used only if the State Commission does not have sufficient information with respect to forward-looking costs to support a rate determination under the pricing principles of the Rules. Once that information is available, the proxies have no effect. But, as the Commission correctly pointed out, the ILECs are in control of that information. Thus it lies largely within their power to produce the information needed to render the default proxies ineffective. Conversely, if the default proxies are stayed, the ILECs have no incentive to cooperate in developing the information necessary to serve as a basis for well-supported determinations of the proper level of competitive pricing.

II. THE PUBLIC INTEREST FAVORS DENIAL OF A STAY.

This case significantly affects an industry touching the lives of almost every American. In these circumstances, the public interest is a "uniquely important consideration" governing an application for interim relief. National Association of Farmworkers Orgs. v. Marshall, 628 F.2d 604, 615 (D.C. Cir. 1980). There are at least two reasons why the public interest favors denial of a stay in this case.

First, the tight deadlines in the Telecommunications Act make it plain that Congress wanted rapid implementation of a competitive structure for local exchange service. And while the Motion argues that the statutory deadlines will be complied with in any case, if the Rules are stayed the ILECs will have every incentive to litigate the meaning of the Act's pricing standards in every State, leading to inevitable delays. The rapid implementation desired by Congress would be more readily achieved if the legal issues the Motion raises are resolved in a single judicial review proceeding involving these Rules, while implementation proceeds at the State level unencumbered by the legal issues being litigated in the Court of Appeals.

Second, any harm suffered by the ILECs during the period of judicial review, in the event the Rules are eventually held to have gone beyond Commission's authority under the Act, would be the result of more competition than the Act authorized the Commission to require. Conversely, any harm suffered by KMC and other prospective competitors during the period of judicial review, in the event a stay is issued and the Rules are eventually sustained, would be the result of less competition than the Act authorized the Commission to require. In determining the equities of a stay application, the basic issue is the relative risks of allowing more or less competition than the Act envisaged during the period of judicial review. Giving the public the benefit of competitive rates in the local exchange service was a primary goal of the

Telecommunications Act. Accordingly, from the standpoint of the Congressional goals and the public interest, overshooting the goal of competition during the interim period of judicial review is clearly preferable than undershooting.

III. THE MOTION DOES NOT DEMONSTRATE A LIKELIHOOD THAT THE RULES WILL BE OVERTURNED ON APPEAL.

A. The Commission's Establishment of Pricing Principles Does Not Intrude on the State Commissions' Authority To Establish Interconnection Rates.

The Motion argues that the Rules are beyond the Commission's authority, because the Act reserves to the State commissions the authority to "establish" rates for interconnection (§ 252(c)(2)) and "determin[e]" whether such rates are just and reasonable under the standards of § 252(d). However, there is a significant difference between determining the principles or methodology to be followed in establishing a rate, and actually applying the principles or methodology to a particular situation. As the Commission well knows, the actual establishment of particular rates can be a lengthy and contentious process even when there is agreement on the governing principles or methodology. There is no basis for the contention that, by setting forth the governing principles or methodology, the Commission has usurped the State commissions' authority under the Act to establish particular rates and determine whether they are just and reasonable.

In that connection, the Commission should make it clear that the pricing principles it has prescribed are necessary to conform to the standards set forth in Section 252(d)(1). As the Commission has observed, Section 252(d)(1)(A) does not specify whether embedded costs or forward-looking costs should be considered in establishing interconnection rates. First Report and Order ¶ 705. But the Commission has also stated that "[p]rices for unbundled elements under Section 251 must be based on cost under the law, and that should be read as requiring that prices be based on forward-looking costs." Report and Order ¶ 620. In interpreting the broad language of § 252(d)(1), the Commission must consider the impact of differing interpretations of this language on the Congressional policies reflected in the Act. "A statute is to be construed in light of the purpose the legislature sought to serve." Environmental Defense Fund v. Reilly, 909 F.2d 1497, 1505 (D.C. Cir. 1990). The Commission correctly found that a pricing methodology based on forward-looking costs "will best ensure the efficient investment decisions and competitive entry contemplated by the 1996 Act." First Report and Order ¶ 705. In addition, as the Department of Justice observed, pricing above forward-looking economic cost would subject competitors to price squeezes, because the real economic cost of a network element for the ILEC would be less than the price that could be charged to the new entrant. First Report and Order ¶ 635, citing DOJ comments. Price squeezes would frustrate realization of the primary goal of the Act, by making it impossible for new entrants to engage in effective local exchange competition. The Commission should make it clear that, for these reason, it interprets Section 252(d), in light of the purpose of the Act to enable effective local exchange competition, to require the establishment of rates in accordance with the forward-looking cost principles set forth in the Rules, in cases where the parties do not voluntarily negotiate different rates.

It cannot reasonably be argued that the Commission lacks authority to issue regulations interpreting the requirements of Section 252(d). Even if the ILECs' crabbed interpretation of the Commission's explicit regulatory authority in Section 251(d)(1) were accepted and that provision were regarded as merely establishing a timetable, the Commission, as the lead federal agency in the administration of the Act, would still have authority to interpret the various provisions of the

Act; and its interpretations would be entitled to deference by the State commissions in their arbitration proceedings and by the federal district courts in reviewing State commission decisions. NLRB v. Town & Country Electric, Inc., 116 S. Ct. 450, 453 (1995); Chevron USA, Inc. v. Natural Resources Defense Council, 467 U.S. 837, 842-45 (1984). The Commission has general authority under Section 4(i) of the Communications Act to "make such rules and regulations . . . not inconsistent with this Act, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i).[2] One of the "functions" the Commission has under the Act is to establish rates in cases where a State commission fails to act. § 252(e)(5). The Commission may utilize the Rules to announce in advance the principles and methodology it will follow in proceedings under § 252(e)(5), rather than proceeding on a case-by-case basis in individual cases of State commission default. In re Permanent Surface Mining Regulations Lit., 653 F.2d 514 (D.C. Cir.), cert. denied, 454 U.S. 822 (1981); National Petroleum Refiners Ass'n v. FTC, 483 F.2d 672 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974).[3]

In short, the Commission should make it clear that the Rules represent an exercise not

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[2] The "Authority" citation in the Rules includes reference to 47 U.S.C. § 154.

[3] National Petroleum Refiners held that the FTC's statutory authority to "make rules and regulations for the purpose of carrying out the [Act]" included authority to specify what constitutes "unfair or deceptive trade practices," where one of the Commission's functions under the Act was to take enforcement action against such practices. Similarly here, where one of the Commission's functions is to establish rates in default of State action, the Commission may specify by regulation, rather than on a case-by-case basis, the principles governing such rates. Such a regulation "serves the 'purpose of shortening and simplifying the adjudicative process and of clarifying the law in advance' and thus . . . aids the Commission in the 'orderly conduct of its business.'" 482 F.2d at 679, quoting U.S. v. Storer Broadcasting, 351 U.S. 192, 202 (1957).

In Re Permanent Surface Mining Regulations Lit. rejected the argument, similar to that advanced by the Motion here, that because the Act contained several grants of rule-making authority on specific subjects, the agency's general rule-making authority (worded similarly to the Commission's authority in § 154(i)) did not extend to any other subject. 653 F.2d at 523.

only of its explicit authority to issue regulations under Section 251(d)(1), but also its full range of authority as the lead federal agency under the Act to interpret the Act and to act where the State commissions fail to do so.

B. The Commission Has Authority To Set Default Proxy Ceilings.

KMC agrees with the Commission that its regulatory authority under § 251(d)(1) is sufficient to support the default proxy ceilings set forth in the Rules. These ceilings do not usurp the States' authority under the Act to establish rates, since they apply only where the State commission lacks information to establish rates based on forward-looking cost. The Rules authorize the State commissions to set rates below the ceilings; and any rate set on a default proxy basis would be superseded once a rate based on forward-looking cost is established. Moreover, the States are required to set rates such that the average rate for a particular network element in a study area does not exceed the proxy, and there may be as few as three areas in the State. First Report and Order ¶ ¶ 784, 765. Thus, even in a default proxy situation, the States may establish individual rates at levels above as well as below the proxy rate.

Moreover, even if § 251(d)(1) were disregarded, the Commission has an alternative basis to establish default proxies. Section 252(e)(5) gives the Commission authority to establish rates where the State commission fails to do so. The default proxy ceilings are expressly limited to cases where the State Commission lacks sufficient evidence to establish rates based on the forward-looking cost principles required by the Commission's Rules and by Section 252(d). The default proxies establish the ceilings that the Commission itself would apply in exercising its default authority to establish rates under Section 252(d). Accordingly, the proxies give a State commission, which does not have sufficient information to establish a permanent rate in accordance with the requirements of the Act, a basis for taking interim action that reflects what would happen if the State commission took no action and the Commission itself had to proceed under its Section 252(e)(5) default authority.

C. The Commission's Authority Is Not Limited To Interstate Communications.

KMC agrees with the Commission's conclusion that sections 251 and 252 "creat[e] parallel jurisdiction for the FCC and the states," covering both intrastate and interstate communications. First Report and Order ¶ 85. The Commission correctly concluded that Congress created "a regulatory system that differs significantly from the dual regulatory system [Congress] established in the 1934 Act." First Report and Order ¶ 83. The legislative history amply demonstrates that Congress intended "revolutionary change," "rewrit[ing] the Nation's communications laws from top to bottom" and "chang[ing] the authority of the Federal Communications Commission."[4] In this context, the Commission correctly concluded that there was a sufficient demonstration of Congressional intent to override the jurisdictional distinctions of Section 2(b). First Report and Order ¶ 93.

Moreover, even if the ILECs were right in arguing that Section 2(b) limits the scope of Section 251(d)(1), there is an alternative basis supporting the Commission's authority to issue the Rules. Section 251(d)(6) provides that State commission determinations are reviewable in federal district court, clearly showing that Congress wanted the law governing application of the pricing standards of Section 252(d)(1) to be developed on a national basis, even where intrastate communication is involved. In this connection, the Commission, as the lead federal agency

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[4] 142 Cong. Rec. S718 (daily ed. Feb. 1, 1996) (Sen. Exon), H1160 (Rep. Barton), S691 (Sen. Stevens), S713 (Sen. Harkin).

involved in the administration of the Act -- as well the agency required to apply Section 252(d)(1) on a default basis when the States fail to act -- is entitled to interpret the requirements of Section 252(d)(1) as they apply to intrastate as well as interstate communications; and the federal district courts will be required to give deference to the Commission's interpretation. In re Permanent Surface Mining Regulations Lit., supra; National Petroleum Refiners Ass'n v. FTC, supra; NLRB v. Town & Country Electric, Inc., supra; USA Chevron, Inc. v. Natural Resources Defense Council, supra. The Commission should make it clear that, in addition to the exercise of its authority under Section 251(d)(1), the rules represent an announcement of the Commission's interpretation of the "just and reasonable" standard of the Act -- in advance of State arbitrations, district court litigation or default proceedings under Section 252(e)(5) -- so that the parties to negotiations and State commission arbitrations may proceed with full awareness of the Commission position.

CONCLUSION

The application for a stay pending appeal should be denied. Any injury claimed by the ILECs during the period of the litigation is offset by injury that KMC and other new entrants to the local exchange would sustain, if a stay were issued. Moreover, the public interest in competitive local exchange rates, as well as the pro-competitive goals of the Act, are more likely to be advanced by allowing competitive entry to proceed according to the framework established by the Rules. In the event that the Rules are overturned, any negotiated agreements or arbitration awards could be appropriately revised; and there is no reason to believe that this process would be any more difficult than the revisions that would be necessary if operation of the Rules were suspended by a stay and the Rules were then upheld.

In addition, the Motion does not demonstrate that the Rules are likely to be overturned on appeal. Section 251(d)(1) gives the Commission ample authority to establishing a pricing principles and methodology for interconnection rates as well as default proxies; and even if section 251(d)(1) were not sufficient, the Commission has sufficient authority under section 4(i).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing OPPOSITION TO JOINT MOTION OF GTE CORPORATION AND THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY FOR STAY PENDING JUDICIAL REVIEW have been served by Hand Delivery (**) or by First Class Mail, postage prepaid, this 4th day of September, 1996, to each on the attached list.

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